

**WEAK INTERNAL CONTROLS
EXPOSED TAXPAYER PAYMENTS TO EMBEZZLEMENT
IN THE DELAWARE-MARYLAND DISTRICT**

June 1999

Reference Number: 190103

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax return/Return information

2d = Law Enforcement Technique(s)

3d = Identifying information - Other Identifying Information of an Individual or Individuals



INSPECTOR GENERAL
for TAX
ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 30, 1999

MEMORANDUM FOR COMMISSIONER ROSSOTTI

David C. Williams

FROM: David C. Williams
Inspector General

SUBJECT: Final Audit Report –Weak Internal Controls Exposed
Taxpayer Payments to Embezzlement in the Delaware-
Maryland District

This report presents the results of our limited scope review of controls over taxpayer account adjustments by Internal Revenue Service (IRS) Collection employees in the Delaware-Maryland District. We conducted this review in conjunction with our Office of Investigations' inquiry involving the embezzlement of delinquent taxes collected by a revenue officer. Approximately \$77,000 was embezzled by the subject revenue officer.

Our tests did not identify any similar instances of embezzlement by other revenue officers in the District. However, adjustments made by revenue officers lacked adequate documentation of managerial approval. In addition, reasonable cause criteria for abatement of penalties and interest were not met in several cases.

We reported our findings to management in an October 14, 1997, memorandum. Management responded by conducting training for all persons involved in the processing of Requests for Adjustment (Forms 3870). They also conducted quarterly post reviews to determine if documentation to support adjustments and revenue officers' understanding of reasonable cause criteria improved. The October 1997 audit memorandum and management's response are included as appendices to this report.

In addition, the report addresses two additional areas that were not included in the audit memorandum. First, Forms 3870 should not be returned to revenue

officers after managerial approval, thus preventing fraudulent adjustments by the revenue officers. Second, revenue officers should not have the ability to submit adjustment documents directly to the Special Procedures Branch, thereby bypassing managerial approval. The District Director agreed with our findings and has taken corrective actions. The Director's response to the findings has been incorporated into the report where appropriate, and the complete text of the response is presented as an appendix to the report.

Copies of this report are also being sent to IRS managers who are affected by the report recommendations. Please call me at (202) 622-6500 if you have any questions, or your staff may contact Pamela J. Gardiner, Deputy Inspector General for Audit, at (202) 622-6510.

**Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District**

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Weak Internal Controls Exposed Taxpayer Payments to Embezzlement in the Delaware-Maryland District

Executive Summary

Weak internal controls and poor management practices enabled an Internal Revenue Service (IRS) Delaware-Maryland District revenue officer (RO) to embezzle taxpayer payments of over \$77,000 during a two-year period. In response to this report, the District has agreed to improve controls over the processing of adjustments to taxpayer accounts by Collection Division personnel (adjustments totaled over \$10 million in Fiscal Year 1998).

We conducted this limited scope review in conjunction with a Treasury Inspector General for Tax Administration inquiry involving the embezzlement of delinquent taxes collected by an RO in the Baltimore, Maryland post-of-duty. Our overall objective was to assess the internal controls over the approval and processing of adjustments to taxpayers' accounts in the Delaware-Maryland District. The audit was conducted in accordance with generally accepted government auditing standards, as they apply to the identification of illegal acts and abuse.

Results

The internal control weaknesses in the processing of taxpayer account adjustments in the Delaware-Maryland District created an environment where fraud occurred and remained undetected. We identified approximately \$77,000 in cashier's checks and money orders embezzled by the subject RO. The RO abated taxpayers' tax liabilities to conceal the embezzlement. Our review of internal controls in this area determined that Forms 3870, Request for Adjustment, lacked adequate documentation of the required managerial approval. In addition, the national guidelines for abating tax liabilities for reasonable cause were not met in several cases.

During the review, we issued a memorandum to the District Director recommending that group managers thoroughly review reasonable cause abatement requests to reduce the risk of employee fraud. While management advised us that corrective actions have been taken to address the lack of documentation and reasonable cause issues, two areas continue to warrant management's attention.

Forms 3870 Should Not Be Returned to Revenue Officers After Managerial Approval

District procedures instruct ROs to submit approval folders containing Requests for Adjustment to their manager. After approval or disapproval of the request(s), the folder is returned to the RO, who forwards the approved requests for input. Proper controls for

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separation of duties would ensure that the approved adjustment requests are forwarded directly from the approving authority to the employees who input the adjustments in the IRS computer system. Otherwise, an unscrupulous RO could alter the adjustment document to conceal the embezzlement of funds.

Revenue Officers Should Not Have the Ability to Submit Adjustment Documents Directly to the Special Procedures Branch

Collection Division management acknowledged that the subject RO could have personally delivered forged adjustment documents to the Special Procedures Branch and placed them with other adjustments awaiting computer input. These forged documents would then be input along with legitimate adjustments.

If weaknesses in these two specific internal control areas are not quickly and effectively addressed, there is an increased risk of additional fraudulent activity by IRS employees and further revenue loss to the Government. Voluntary compliance is threatened when the IRS cannot assure the public that its internal controls prevent fraud, waste and abuse in tax administration activities.

Management's Response: District Collection management agreed that the current procedures lacked proper separation of duties in the two areas cited above. New procedures have been implemented to address these weaknesses. Management's complete response is included in Appendix VI of this report.

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Objective and Scope

We assessed the internal controls over the approval and processing of adjustments to taxpayers' accounts by ROs in the same POD as the suspect employee.

Our overall objective was to assess the internal controls over the approval and processing of adjustments to taxpayers' accounts in the Delaware-Maryland District. We conducted portions of the review concurrent with a Treasury Inspector General for Tax Administration criminal conduct investigation of a Baltimore post-of-duty (POD) revenue officer (RO) who had embezzled over \$77,000.

To accomplish our objective we:

- Determined the extent of the embezzlement by the subject RO.
- Identified the control weaknesses that permitted the embezzlement to occur and remain undetected.
- Determined if this type of embezzlement activity was widespread among other ROs in the same POD.

We conducted this limited scope review from February 1997 to September 1998, in accordance with generally accepted government auditing standards, as they apply to the identification of illegal acts and abuse. Appendix I presents our detailed objectives, scope and methodology. Appendix II provides a listing of the major contributors to this report.

During the review, we issued an audit memorandum communicating several issues requiring immediate attention. This report presents both a summary of the findings reported in the memorandum and our findings on additional audit results developed after the date of the memorandum. A copy of the memorandum is included in Appendix IV. Management's response to the memorandum is presented in Appendix V.

Background

The RO, whose name appeared on the check, was subsequently arrested and admitted to embezzling numerous payments from taxpayers starting in early 1995. The investigation proved that the RO embezzled funds and attempted to cover up the scheme by abating penalties and interest on the accounts from which the funds were stolen. The RO could not recall how many taxpayer accounts had been altered.

Results

The internal control weaknesses in the processing of taxpayer account adjustments created an environment where fraud occurred and remained undetected. These weaknesses included the approval of Forms 3870, Request for Adjustment, without adequate supporting documentation and the approval of abatements that did not meet reasonable cause criteria.

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The RO embezzled approximately \$77,000 in cashier's checks and money orders.

Our review showed that the subject RO altered approximately \$77,000 in cashier's checks and money orders received from taxpayers and deposited them into a personal checking account.

We analyzed 32 additional cases of the subject RO and over 300 cases worked by approximately 60 other ROs in the Delaware-Maryland District to identify any similar fraud in their Requests for Adjustments.

Six additional cases were referred to Investigations for further review.

We referred six cases to our Office of Investigations that did not contain adequate documentation to justify the requests for abatement of over \$85,000 in penalties.

Collection Division management advised us that they have taken several steps to strengthen controls and increase the awareness of proper processing of Requests for Adjustments. These steps include training for all persons involved in the processing of the requests, from initiation to final disposition, and quarterly post reviews of a sample of processed RO abatements.

Although these actions should improve the processing of Form 3870 adjustments, there are still two areas that warrant management's attention.

- Forms 3870 should not be returned to ROs after managerial approval.
- ROs should not have the ability to submit adjustment documents directly to the Special Procedures Branch (SPB).

Forms 3870 Should Not Be Returned to Revenue Officers After Managerial Approval

Control weaknesses permitted the introduction of forged documents into adjustment processing.

According to District Collection procedures, ROs submit approval folders containing Requests for Adjustment to their managers. After approval or disapproval of the request(s), the folder is returned to the RO. If approved, the RO submits the documents to the group secretary for forwarding to the SPB.

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Collection Division management suspects that the subject RO may have added additional adjustment requests to the folder after the group manager's approval. We have no evidence that supports their contention; however, in our discussion of the 32 additional cases worked by the subject RO, management stated that it was possible some of the fraudulent adjustments may have been processed in this manner.

A proper system of internal controls provides for separation of key duties and responsibilities between authorizing, processing, recording, and reviewing transactions. Therefore, approved Forms 3870 should not be returned to ROs after managerial approval. In addition, employees who receive and process (input) adjustments to taxpayers' accounts should be instructed not to accept adjustment requests from someone other than an authorized management official.

Management's Response:

Collection Division management agreed that the current procedures lacked proper separation of duties and did not ensure that adjustment requests are forwarded directly from the approving authority to the employees who input the adjustments to the taxpayers' accounts in the IRS computer system.

The new procedures require that after Forms 3870 are approved by the group manager, they will be forwarded directly to the group secretary for transmittal to the SPB or to a Remote Terminal Operator (RTO) in an outlying POD for input using ENTITY (automated inventory tracking system) transmittal forms. Part 3 of the Form 3870 will be returned to the RO for inclusion in the case file. The SPB and the RTOs will not accept any Forms 3870 for input that have not been forwarded on an ENTITY transmittal. ENTITY transmittals are to be completed only by the group secretaries.

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Revenue Officers Should Not Have the Ability to Submit Adjustment Documents Directly to the Special Procedures Branch

*ROs had access to adjustment
inventory in the SPB.*

Existing procedures do not prevent ROs from gaining access to the area where the Forms 3870 are input to the IRS computer system terminals. Collection Division management acknowledged that the subject RO could have walked forged adjustment documents directly to the SPB and placed them into the adjustment inventory to await computer terminal input. These forged documents would then be input along with the legitimate adjustments.

*Collection Division
management believes that
some approval signatures
were forged.*

Management believes that signatures were forged in 2 of the 12 cases where funds were embezzled and in 6 of the 32 adjustment cases where no funds were embezzled.

It is feasible that the RO forged his manager's signature to get fraudulent Forms 3870 processed. However, if managers stopped giving the folders with approved Forms 3870 back to the ROs and implemented procedures to prevent ROs from placing adjustment documents into the processing stream, the likelihood for fraudulent adjustments to be processed and remain undetected will be greatly diminished.

*Access to resources should be
limited to authorized
individuals.*

A proper system of internal controls limits access to resources to authorized individuals. Therefore, management needs to improve its system of internal controls to prevent the insertion of forged adjustment documents into the processing stream. In this regard, employees who receive and process (input) adjustments to taxpayers' accounts should be instructed not to accept adjustment requests from someone other than an authorized management official.

Management's Response:

All Collection Forms 3870 are now input by the SPB or by RTOs in outlying PODs. The Forms 3870 are transmitted to the SPB or the RTOs via the ENTITY Group Daily document. Collection Division management issued a memorandum restating that Forms

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3870 requiring processing outside of the ENTITY Group Daily should only be delivered by the originating group manager.

Conclusion

Collection Division management should ensure that controls are in place to reduce the risk of fraud.

Collection Division management should continue the special periodic quality review of RO Requests for Adjustment to ensure that a proper understanding of adjustment reasonable cause criteria exists. In addition, management should ensure that proper controls are in place to guard against fraud and to ensure that Requests for Adjustment are properly approved, adequately documented, and based on authorized criterion.

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Appendix I

Detailed Objectives, Scope and Methodology

Our overall objective was to assess the internal controls over the approval and processing of adjustments to taxpayers' accounts in the Delaware-Maryland District. We conducted our limited scope portion of the review concurrent with providing assistance to Treasury Inspector General for Tax Administration (TIGTA) Office of Investigations in its criminal conduct investigation of a Baltimore post-of-duty revenue officer (RO). The RO had embezzled over \$77,000 in collected delinquent taxes. We began our assistance efforts in February 1997 and completed our limited scope review in September 1998.

To accomplish our objective, we conducted the following sub-objectives and tests:

- I. To determine the extent of the RO's embezzlement, the following actions were taken:
 - A. Reconciled the subject RO's case inventory with the Delinquent Investigation/Account Listing (DIAL);
 - B. Analyzed audit trail information on the subject RO and requested electronic Master File transcripts in order to request source documents on identified abatements;
 - C. Analyzed Forms 3870, Request for Adjustment, and support documentation to look for trends and to substantiate justification for abatements;
 - D. Reviewed the District walk-in log to identify taxpayers assisted by the subject RO;
 - E. Searched closed case files;
 - F. Analyzed the subject RO's bank statements and identified irregular deposits;
 - G. Reviewed Forms 795, Daily Report of Collection Activity, on the subject RO to identify any unusual activity, such as:
 - 1. Numerous adjustment requests made on the same day.
 - 2. Adjustments submitted while an acting manager was in place.
 - H. Determined how the subject RO adjusted taxpayer accounts to hide his embezzlement actions;

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- I. Explored the possibility of collusion between the subject RO and other employees; and
- J. Reviewed the subject RO's Official Personnel Folder for conflicts of interest.
- II. To determine the control weaknesses that allowed the embezzlement to both occur and remain undetected, the following steps were completed:
 - A. Evaluated RO abatement request justifications and compared the justifications to the Internal Revenue Manual (IRM) criteria;
 - B. Identified abatement discrepancies and discussed the exception cases with management;
 - C. Discussed program procedures with District management to identify control weaknesses that could have been exploited; and
 - D. Determined Collection Division management's role in case processing and noted controls that could be bypassed.
- III. To determine if this type of embezzlement activity was widespread among other ROs in the same post-of-duty, the following actions were completed:
 - A. Used the DIAL to identify other ROs in the District that had high abatement requests and ordered complete bulk Master File Transcripts (MFTRA) for the taxpayers identified;
 - B. Placed the Master File and DIAL data in a database and determined the number of accounts with adjustments assigned to each RO;
 - C. Used MFTRA information to identify and request Integrated Data Retrieval System (IDRS) adjustment documents for approximately 1,300 separate taxpayer account transactions;
 - D. Reviewed IDRS documentation for over 1,000 of the 1,300 adjustments and identified over 300 adjustments that were the result of Forms 3870; and
 - E. Determined whether reasonable cause justifications on the source documents attached to the 300 Forms 3870 were consistent with IRM criteria.

Major Contributors to This Report

M. Susan Boehmer, Acting Regional Inspector General for Audit

Thomas H. Black, Audit Manager

Barry G. Huff, Senior Auditor

Steve W. Gibson, Auditor

Tracy K. Harper, Auditor

Robert J. Leeke, Auditor

Kim M. McManis, Referencer

Jack E. Forbus, Referencer

Charlene L. Elliston, Referencer

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Appendix III

Report Distribution List

Chief Operations Officer C:OP

Assistant Commissioner (Collection) OP:CO

National Director, Collection Field Operations OP:CO:C

National Director for Legislative Affairs CL:LA

Office of Management Controls M:CFO:A:M

Regional Commissioner, Southeast Region RC

Regional Chief Compliance Officer, Southeast Region RCCO

Director, Delaware-Maryland District

Office of Audit Liaisons:

Regional Controller's Office, Southeast Region

Assistant Commissioner (Collection)

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Appendix IV

Internal Revenue Service
memorandum

date: October 14, 1997

to: District Director
Delaware - Maryland District

Thomas H. Black

from: Audit Manager
Southeast Region

subject: **Review of Abatements Associated with a Revenue Officer's Embezzlement**

We assisted Internal Security from February to June 1997, in an investigation involving embezzlement by a Revenue Officer in the Delaware-Maryland District. This memorandum includes the scope and results of the work we completed with Internal Security. We are providing this memorandum for your information. The scope of our review was limited therefore your corrective action may be targeted to assessing controls beyond the subject Revenue Officer. Please forward any planned corrective action(s) to the Regional Inspector within 30 workdays of the memorandum date. Your response should also contain all the information required by the Internal Revenue Manual (IRM) Section 1289.2.

Background

Internal Security began investigating the subject Revenue Officer (RO) after receiving information 1-----
1-----

The RO provided a signed affidavit to Internal Security admitting to embezzling funds from taxpayers.

As part of our limited review, we obtained a download of the subject RO's audit trail. We ordered electronic master file transcripts for these cases and identified those with abatement actions. For cases with abatement actions, we ordered and reviewed the applicable adjustment documents. We reviewed the Collection District walk-in log and

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identified cases worked by the subject RO. We searched closed Collection files to identify and review cases assigned to the subject RO.

We performed this project in accordance with generally accepted government auditing standards as they apply to the identification of illegal acts and abuse. We did not perform a typical program audit as prescribed in the General Accounting Office's Government Auditing Standards, which are designed to determine:

- the extent to which desired results/benefits were being achieved;
- the effectiveness of Service's programs, activities or functions; and,
- whether the Service has complied with Internal Revenue Manual procedures or other applicable regulations.

The subject RO altered approximately \$77,000 in cashier's checks and money orders to embezzle taxpayer payments.

Results

Internal Security determined that the subject RO altered approximately \$77,000 in cashier's checks and money orders he received from taxpayers and deposited these funds into his personal checking account. The subject RO stated he abated penalties so that there would be no balances still owed by the taxpayer.

Our tests determined that internal controls did not prevent improper reasonable cause abatements.

Internal Audit reviewed available source documents for 12 embezzlement cases. In 8 of the 12 cases, the subject RO completed reasonable cause abatement requests in an attempt to hide his fraudulent actions.

- In 5 cases, the RO successfully had abatement requests processed. In 3 of the 5 cases, reasonable cause criteria were not met.
- The RO prepared abatement requests that were not yet approved in 2 of the embezzlement cases.
- A Group Manager denied abatement requests prepared in one embezzlement case.

The RO justified abatements for the three embezzlement cases by using explanations that did not meet reasonable cause criteria.

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Abatements were processed
that did not meet reasonable
cause criteria.

1-----

1-----
1-----
1-----

1----- According to the IRM, in order to qualify for a
reasonable cause abatement due to illness, the individual
having sole authority to file the return must be ill. A
Group Manager stated that the reasonable cause
abatement approvals were forged in this case.

1-----

1-----The IRM specifically states that
reliance on the advice of a competent tax advisor does
not provide a basis for a waiver of the estimated tax
penalty. A Group Manager could not determine whether
the approval signature on the abatement request was
valid.

1-----

1----- None of these circumstances meet
the IRM criteria for reasonable cause abatements. A
Group Manager approved the abatements.

In addition to the 12
embezzlement cases we
reviewed 32 other cases in
which the subject RO
requested abatements.

To determine the extent of the RO's abatement
activities, we requested source documents for accounts
the subject RO accessed on IDRS. From this analysis
we identified 32 additional taxpayers for whom the
subject Revenue Officer requested abatements totaling
approximately \$280,000. Documentation was not
present to support over \$74,000 in abatements in 9 of
the 30 (30%) of the cases with abatements over \$500.
Additionally, over \$9,000 in abatements were processed
without managerial approval. We were not able to
review case files for 7 of these 9 cases. Collection

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believes that some of the managerial approvals were forged by the RO in 6 of the 9 cases.

In 1 of the 32 taxpayer cases involving over 1-----

1-----

1----- Collection believes that some of the abatement request approvals were forged in this case.

The Branch Chief said that Group Managers and Acting Group Managers perform daily spot checks on approved abatement cases. However, Group Manager checks did not identify any of the 8 cases Collection believes may involve forged adjustment approvals. The Branch Chief stated the suspect RO may have added forged abatement requests to the RO's approval folder after a Group Manager reviewed the RO's daily work and returned the folder to the RO. The RO could then provide the approved documents with the added abatements to the group secretary. The Branch Chief said that the group secretary would be unlikely to catch additional adjustments added by the RO.

The Branch Chief also said that the subject RO could have walked forged adjustment documents down to the Special Procedures Branch (SPB) without making an entry for the adjustments on the Entity Daily Report by waiting until the SPB had separated the Entity Daily Report from the cases.

Group Managers must thoroughly review reasonable cause abatement requests in order to reduce the risk of employee fraud. The manager's review should determine whether the RO provided adequate supporting documentation establishing a taxpayer's basis for a reasonable cause abatement.

Managerial reviews should determine if adequate documentation is present to support the abatement.

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Appendix V



Department of the Treasury
Internal Revenue Service

Date: AUG 12 1998

To: Regional Inspector, Southeast Region
Thru: Regional Commissioner, Southeast Region
Attn: Regional Chief Compliance Officer

From: District Director
Delaware-Maryland and Southeast Key District (BP/EO)

Subject: Internal Audit Report - Review of Abatements Associated
with a Revenue Officer's Embezzlement



Attached is the final report of the completed actions that appropriately addresses each area of concern in the above referenced Internal Audit Report. Also attached are the review results for the quarterly review of adjustments as required by the Regional Chief Compliance Officer, Southeast Region.

If you need additional information, please feel free to contact me or, if you prefer, a member of your staff may contact Rick Skorny, Chief, Collection Division at (410) 962-3070.


Paul M. Harrington

Concurrence: _____
Regional Commissioner Date

Attachment
cc: Regional Controller (with attachment)
Southeast Region

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Regional Inspector

Corrective Actions:

1A - Corrective Action: District management will conduct a post review of the abatements approved and processed by revenue officers and Face-to-Face employees from June 1997 through September 1997. This review will look for discrepancies or variances with IRM, LEM V, and reasonable cause criteria, and use source documents to verify management approval of these abatements.

Actions Taken: Internal Audit assisted our office in securing the sample of cases for review. They requested audit trails for FY 97 and loaded them into an ACCESS data table. Queries were developed to identify and pull out adjustment transactions [REDACTED] for the specified timeframe. A sample of 50 adjustments was selected for Bulk MFTRA research. A listing was forwarded to our office and the adjustment documents were requested from the Philadelphia Service Center via the command code Estab. The documents for a total of 56 tax periods were requested. Subsequent to securing these older tax periods for review, reviews had been conducted on more recent adjustment documents.

Results: A total of 31 entities involving 43 modules were reviewed. The other entities requested from the Service Center were either already charged-out or not available. The results of this review clearly showed that the District has made significant improvement in the quality of Form 3870 processing. Adjustments for 30 modules (19 entities) were requested by revenue officers. Source documents with the appropriate documentation for 24 of the 29 modules were received. In six (6) of the 24 modules, group manager approval had not been secured on the adjustment. It could not be determined if group manager approval had been secured on the remaining five (5) cases because no source document had been received.

Face-to-Face personnel prepared adjustments for 13 modules (12 entities). Although adjustments by Face-to-Face personnel can be prepared based solely on oral testimony, five of the adjustments had the documentation attached. No problems were noted regarding the appropriateness of the remaining adjustments.

1B - Corrective Action: District management will conduct training for all collection employees involved in this process, from origination to final disposition of the cases, to ensure that each employee and manager understand his or her responsibilities and the appropriate IRM, LEM V, reasonable cause requirements

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Regional Inspector

Actions Taken: Actions completed. Upper management shared the results of the review with branch chiefs and managers. Managers have been instructed to review the requirements for reasonable cause and the LEM V criteria. They have also been instructed to carefully review all adjustments requiring managerial approval before signing. The review should include checking the history for any discrepancies. Managers cover this topic in their group meetings. A training session was held during revenue officer CPE in June 1998.

1C - Corrective Action: Division and branch management will conduct quarterly post reviews of a sample of processed revenue officer abatements, face-to-face adjustments, and SPB adjustments.

Actions Taken: A sample of Forms 3870 processed for 37 entities containing 51 modules were pulled from CFF, Special Procedures and the Face-to-Face operation. The Forms 3870 reviewed were processed from November 1997 through May 1998.

Results:

Collection Field Function

A sample of Forms 3870 for 8 entities involving 16 modules prepared by field revenue officers was reviewed. The required documentation, managerial approval, revenue officer signature, and other information were complete for all 16 modules. Revenue officers attached more documentation to their adjustments in the review sample. In addition to the taxpayer's letter, copies of returns, etc. were attached. All adjustments except for one (1) involved reasonable cause so this is an area that we will continue to focus our training efforts.

Special Procedures Branch

Forms 3870 prepared by Special Procedures Branch personnel for nine (9) entities involving 13 modules were reviewed. Most of the adjustments related to bankruptcy. On these cases, IDRS prints are attached. All the adjustments had been signed by the employee and manager. No problems were identified in any of these cases.

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Regional Inspector

Face-to-Face

There were 20 entities reviewed involving 22 modules for Face-to-Face employees. These employees routinely prepare adjustments for most issues based solely on oral testimony. They do prepare source documents to send to the Service Center that are matched by the Service Center against the transaction that was input.

The Face-to-Face adjustments involved correcting misapplied payments, locating payments, documenting filing status and personal exemptions, and ensuring taxpayers were given the earned income credit. All adjustments reviewed were appropriate. It is being recommended locally that the employee input their name as well as employee number when inputting the adjustments. This will make it easier to identify the person who input the adjustment without having to secure a list with IDRS employee numbers.

SUMMARY

The results of the adjustment documents reviewed for Action Item 1A clearly reflected areas requiring improvement. The documents were selected from June 1997 through September 1997, prior to the implementation of our action plan. Since that time, management has identified the areas for improvement through several reviews and has aggressively implemented a plan to correct these areas. Actions taken include extensive training at CPE and in each field group. At CPE, the assistance of the Taxpayer Advocate's office was enlisted. They prepared and distributed to each revenue officer an excellent training tool on adjustments. The document discussed the various adjustments, how to prepare the adjustment document, and detailed the documentation required to support the adjustment request. Results of the adjustment reviews are shared with the managers and employees. Reviews conducted on adjustments prepared after the implementation of our action plan reflect significant improvement in the quality of the adjustments prepared by the Collection Field Function. Special Procedures and Face-to-Face employees continue to do an excellent job on adjustments.

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Regional Inspector

The District will continue to work with revenue officers in the area of reasonable cause criteria since the majority of the adjustments prepared involve reasonable cause. As stated above, locally, we will request that Face-to-Face personnel include their name when inputting on-line adjustments. Without benefit of a source document, this will allow for easy identification of the person who input the adjustment. All Collection managers will continue to discuss the quality of adjustments with their employees. They will review adjustments submitted by employees to ensure the appropriate documentation has been secured.

Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District

Internal Revenue Service
memorandum

date: JUN 01 1998

to: Regional Inspector
Southeast Region

from: Chief Compliance Officer
Southeast Region

subject: Draft Internal Audit Report – Review of Abatements Associated with a Revenue Officer's Embezzlement

Attached is a status report of completed and in-process actions on the action and management response provided by the Delaware-Maryland District. We reviewed the report and concur with their progress.

If you have any questions, please contact Compliance Analyst Jim Lasseter at (404) 331-4045.

for B Charamida
Bobby E. Scott

Attachment

Concurrence: *James L. [Signature]*

Regional Controller

Date: 6/1/98

RECEIVED

JUN 2 9 50 AM

SOUTHEAST REGION

Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District



**Department of the Treasury
Internal Revenue Service**

Date: MAY 14 1998

To: Regional Inspector, Southeast Region
Thru: Regional Commissioner, Southeast Region
Attn: Regional Chief Compliance Officer

From: District Director
Delaware-Maryland and Southeast Key District (EP/EO)

Subject: Internal Audit Report - Review of Abatements Associated
with a Revenue Officer's Embezzlement

Attached is a status report of completed and in-process actions on our action plan and management response which appropriately addresses each area of concern in the above referenced Internal Audit Report.

If you need additional information, please feel free to contact me or, if you prefer, a member of your staff may contact Rick Skorny, Chief, Collection Division at (410) 962-3070.


Paul M. Harrington

Concurrence:

Regional Commissioner

Date

Attachment

cc: Regional Controller (with attachment)
Southeast Region

**Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District**

-2-

Regional Inspector

Corrective Actions:

1A - Corrective Action: District management will conduct a post review of the abatements approved and processed by revenue officers and Face-to-Face employees since June 1, 1997. This review will look for discrepancies or variances with IRM, LEM V, and reasonable cause criteria, and use source documents to verify management approval of these abatements.

Actions Taken: In our February 17, 1998 status report, we reported the results of our review of Forms 3870 processed from October 1997 through January 1998. Internal Audit needs additional time to secure transcripts and order the Service Center source documents for abatements requested between June and September 1997. The review and analysis of these transcripts will be completed within 30 days of receipt from Internal Audit.

Implementation Date: July 15, 1998

1B - Corrective Action: District management will conduct training for all collection employees involved in this process, from origination to final disposition of the cases, to ensure that each employee and manager understands his or her responsibilities and the appropriate IRM, LEM V, reasonable cause requirements.

Actions Taken: Upper management shared the results of the review with branch chiefs and managers. Managers have been instructed to review the requirements for reasonable cause and the LEM V criteria. They have also been instructed to carefully review all adjustments requiring managerial approval before signing. The review should include checking the history for any discrepancies. Managers are covering this topic in their group meetings.

The Collection Training Committee has developed a training plan (see attachment). The training was completed during March 1998. Additional training will be held in June 1998 during Revenue Officer CPE.

Implementation Date: Completed

1C - Corrective Action: Division and branch management will conduct quarterly post reviews of a sample of processed revenue officer abatements, Face-to-Face adjustments, and SPB adjustments.

Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District

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Regional Inspector

Actions Taken: A sample of Forms 3870 processed for 34 entities containing 52 modules were pulled from Special Procedures and the Face-to-Face operation. The Forms 3870 reviewed were processed from November 1997 through April 1998.

Results:

Collection Field Function

A sample of Form 3870s prepared by field revenue officers for 10 entities (26 modules) were reviewed. The required documentation, managerial approval, revenue officer signature, and other information was completed for 25 of the 26 modules. Revenue Officers attached more documentation to their adjustments in the review sample. In addition to the taxpayer's letter, copies of returns, W-2/W-3 forms, etc. were attached. Only one (1) adjustment in the sample did not have a request from the taxpayer attached. The revenue officer had prepared returns under 6020(b) procedures. Per the taxpayer, the business ceased operation and was not liable for the 6020(b) period. A letter from the taxpayer certifying the date on which the business ceased to operate should have been attached.

On another case, the appropriate documentation was attached to the adjustment. It included the taxpayer's letter and medical documentation from the taxpayer's doctor. The revenue officer abated penalties for 17 tax periods extending from September 1989 through March 1994. The question arises as to whether the taxpayer could claim reasonable cause over such an extended period of time. If the business continued to successfully operate, it is reasonable to believe the returns could have been filed and paid timely. The taxpayer remains in non-compliance at this time. Additional adjustment training has been scheduled for June 1998 and the issue regarding the appropriateness of abatements spanning such a lengthy period will be addressed in our June 1998 adjustment training.

The review showed marked improvement in the documentation revenue officers provide for adjustments. We will continue working with the revenue officers to increase their understanding of reasonable cause. It was noted that all adjustments had been approved by the group managers.

Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District

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Regional Inspector

Special Procedures Branch

Forms 3870 prepared by Special Procedures Branch personnel for five (5) entities involving five (5) modules were reviewed. Three cases involved related to abatements for bankruptcy. All had been signed by the employee and manager. No problems were identified in any of these cases.

Face-to-Face

There were 20 entities reviewed involving 21 modules for Face-to-Face employees. These employees routinely prepare adjustments for most issues based solely on oral testimony. They do prepare source documents to send to the Service Center which are matched by the Service Center against the transaction that was input.

The Face-to-Face adjustments involved correcting misapplied payments, locating payments, documenting filing status and personal exemptions, and ensuring taxpayers were given the earned income credit. All adjustments reviewed were appropriate. Although not necessary, 15 of the 21 adjustments had documentation attached.

SUMMARY

The review results reflected an improvement in the quality of the adjustments prepared by the Collection Field Function. Special Procedure and Face-to-Face employees continue to do an excellent job on adjustments. The District will continue to work with revenue officers in the area of reasonable cause criteria. As stated above, we will also address with the revenue officers the number of modules which should be considered for abatement of the penalty when the request involves several years. In addition, all Collection managers will continue to discuss the quality of adjustments with their employees. They will review adjustments submitted by employees to ensure the appropriate documentation has been secured.

Delaware/Maryland District ACTION PLAN

Training on Adjustments

I. Adjustments

A. Reasonable cause

- 1. Reviewing the TXMOD**
- 2. TC 290 (Appeal rights)**
- 3. LEM**

B. Other Adjustments

- 1. Corrections to TFRP**
- 2. SFR/Audit reconsiderations**
- 3. CAWR**
- 4. 6020(b)**
- 5. 940C's**
- 6. Non-reasonable cause penalties**
- 7. systemic vs. non-systemic**

C. Form/document preparation

D. Approvals

- 1. History**
- 2. Attachments**

II. Taxpayer Advocate's Office

A. PRP criteria

B. ATA0's (as noted in meeting minutes this will be delayed until a later date)

C. Internal advocacy issues

III. Taxpayer Relief Act of 1997

**Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District**

FEB 17 1986

Regional Inspector, Southeast Region
Thru: Regional Commissioner, Southeast Region
Attn: Regional Chief Compliance Officer

District Director
Delaware-Maryland and Southeast Key District (EP/EO)

Internal Audit Report - Review of Abatements Associated
with a Revenue Officer's Embezzlement

Attached is a status report of completed and in-process
actions on our action plan and management response which
appropriately addresses each area of concern in the above
referenced Internal Audit Report.

If you need additional information, please feel free to
contact me or, if you prefer, a member of your staff may
contact Rick Skorny, Chief, Collection Division at
(410) 962-3070.

/s/ Paul M. Harrington
Paul M. Harrington

Concurrence: _____
Regional Commissioner Date

Attachment
cc: Regional Controller (with attachment)
Southeast Region

**Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District**

-2-

Regional Inspector

Corrective Actions:

1A - Corrective Action: District management will conduct a post review of the abatements approved and processed by revenue officers and Face-to-Face employees since June 1, 1997. The Chief, Field Branch I will coordinate this review, using a sample compiled with the help of DORA and Internal Audit. This review will look for discrepancies or variances with IRM, LEM V, and reasonable cause criteria, and use source documents to verify management approval of these abatements.

Actions Taken: A sample of Forms 3870 processed for 137 modules involving 76 entities were pulled from Special Procedures and the Philadelphia Service Center for review. The sample included adjustments prepared on 42 entities by revenue officers and 16 adjustments prepared by Face-to-Face personnel. The sample was also expanded to include adjustments prepared on 18 entities by Special Procedures Branch Advisors and TEAs.

The Forms 3870 reviewed were processed during October, November and December 1997 as well as January 1998. We are still trying to secure a listing of accounts processed from June 1997 through October 1997 for review.

Results:

Collection Field Function

Adjustments for a total of 42 entities involving 93 modules prepared by revenue officers were reviewed from the field. The required documentation, managerial approval, revenue officer signature, and other information was provided for 86 of 93 modules. Two (2) of the adjustments had the actual case history attached. Adjustments were prepared for 18 modules without any documents attached.

It appears that seven (7) modules required either a letter from the taxpayer or documentation from third parties such as Special Procedures Branch or District Counsel that was not attached to the Form 3870. (See taxpayers 24, 38, 54, 55, 58, 59, 60.) Reasonable cause was cited for two (2) cases in which no letter from the taxpayer was attached detailing the purpose for requesting the abatement. In addition, the reasonable cause cited is questionable. (See taxpayers 24 and 55.) There were letters attached for three (3) taxpayers requesting abatement based on reasonable cause that did not appear to fall into any of the categories for reasonable cause criteria. (See taxpayers 2, 12, 37, and 40.)

Weak Internal Controls Exposed Taxpayer Payments to Embezzlement in the Delaware-Maryland District

-3-

Regional Inspector

Although the review reflects some areas in which we must improve the revenue officer's understanding of reasonable cause, overall, the quality of the adjustments were good. The appropriate documentation was attached and group managers reviewed the Forms 3870 before processing as evidenced by their signature. This included acting managers.

Special Procedures Branch

Forms 3870 prepared by Special Procedures Branch personnel for 18 entities involving 28 modules were reviewed. Twenty of 28 modules involved abatements related to bankruptcy. All but one Form 3870 was signed by a manager (16) and only one had not been signed by an employee, but it was signed by a manager. The remaining eight (8) adjustments had been signed by both employee and manager. The issues involved included abatement of lien fees, difficulty in tax law, and assets tied up in litigation due to death of taxpayer.

Face to Face

Sixteen Forms 3870 for 16 modules were reviewed for the Face-to-Face operation. These employees routinely prepare adjustments for most issues based solely on oral testimony. They do prepare source documents to send to the Service Center which are matched by the Service Center against the transaction that was input.

Face-to-Face employees did attach documentation to nine (9) of the sixteen accounts. Adjustments issues included posting payments to the correct TIN or tax period and abating the penalty and interest accordingly. There were also adjustments which increased federal withholding (returns and W-2s were secured to support the TP's request). There were three (3) adjustments in which the taxpayer was claiming another exemption. In two of the cases, the taxpayers provided either a birth certificate or other documentation. But there was no documentation attached for the third taxpayer (72). When taxpayers claim additional exemptions, they are required to provide substantiation.

SUMMARY

The initial review results reflected overall good quality of the Forms 3870 prepared by Collection Field Function, Special Procedure Branch, and Face-to-Face employees. However, it also noted some areas for improvement. The District will continue to work with revenue officers in the area of reasonable cause criteria. In addition, all Collection managers will continue to discuss the quality of adjustments with their employees. They

**Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District**

-4-

Regional Inspector

will review adjustments submitted by employees to ensure the appropriate documentation has been secured.

A training plan has been developed and target dates for training have been sscheduled throughout March, 1998. It will include the areas requiring improvment that were identified in this review.

1B - Corrective Action: District management will conduct training for all collection employees involved in this process, from origination to final disposition of the cases, to ensure that each employee and manager understands his or her responsibilities and the appropriate IRM, LEM V, reasonable cause requirements.

Actions Taken: Upper management shared the results of the review with branch chiefs and managers. Managers have been instructed to review the requirements for reasonable cause and the LEM V criteria. They have also been instructed to carefully review all adjustments requiring managerial approval before signing. The review should include checking the history for any discrepancies. Managers are covering this topic in their group meetings.

The Collection Training Committee has developed a training plan (see attachment). The training is being scheduled throughout March, 1998. The training will cover reasonable cause, LEM V criteria, and other adjustments. We have requested that a member of the Taxpayer Advocate's Office assist us with this training.

Implementation Date: 4/15/98

1C - Corrective Action: Division and branch management will conduct quarterly post reviews of a sample of processed revenue officer abatements, using the same criteria as Corrective Action 1A.

Actions Taken: We will work with DORA and Internal Audit to secure listings for Forms 3870 prepared June, 1997 through October, 1997. Special Procedures Branch and Face-to-Face will continue to provide samples of recently processed adjustments for review.

Results: Future quarterly reviews will be conducted using samples from June, 1997 and forward.

Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District

**Internal Revenue Service
memorandum**

**Received
12/2/1997**

date: NOV 25 1997

to: Regional Inspector, Southeast Region
thru: Regional Commissioner, Southeast Region
Attn: Chief Compliance Officer, Southeast Region

from: District Director
Delaware-Maryland

subject: Internal Audit Report - Review of Abatements Associated with a Revenue Officer's
Embezzlement

Attached is our action plan and management response which appropriately addresses the area of concern in the above-referenced Internal Audit Report.

The report confirms that the revenue officer lied, forged signatures, and willfully circumvented group controls that were in place, to steal about \$77,000.00. The Integrated Collection System will help us prevent this type of activity. I think that it is imperative that we move quickly to upgrade our systems to prevent this type of abuse. As you know, the implementation date for the Delaware-Maryland District has slipped until late 1999. In the interim, we will conduct manual reviews to improve our control systems.

If you need additional information, please feel free to contact me or, if you prefer, a member of your staff may contact Mary Quiroz, Acting Chief, Collection Division at (410)962-3070.


Paul M. Harrington

Concurrence:


Regional Commissioner

12/3/97
Date

Attachment

CC: Regional Controller (with attachment)
Southeast Region

Internal Revenue Service
memorandum

Weak Internal Controls Exposed Taxpayer Payments to Embezzlement in the Delaware-Maryland District

Identity of Finding

Internal controls did not prevent improper reasonable cause abatements.

Assessment of Cause

Internal Audit found two problems with management controls which contributed to the ability of the subject RO to embezzle funds. These problems are as follows:

1) Abatements were approved and processed which did not meet reasonable cause criteria. 2) Abatements were approved and processed without the appropriate supporting documentation required for the abatements.

The Internal Audit Report describes those cases which management could not control because the subject RO forged a manager's signature. In the other cases, we agree that District management can take specific actions to educate revenue officers in the IRM and LEM requirements for abatements, strengthen management controls over the approval process, and conduct post reviews to ensure that the education and strengthened controls have corrected the Internal Audit finding.

Corrective Actions:

1A - Corrective Action: District management will conduct a post review of the abatements approved and processed by revenue officers and Face-to-Face employees since June 1, 1997. The Chief, Field Branch I will coordinate this review, using a sample compiled with the help of DORA and Internal Audit. This review will look for discrepancies or variances with IRM, LEM V, and reasonable cause criteria, and use source documents to verify management approval of these abatements.

Implementation Date: Proposed completion date: February 15, 1998.

Responsible Official: Chief, Collection Division

1B - Corrective Action: District management will conduct training for all collection employees involved in this process, from origination to final disposition of the cases, to ensure that each employee and manager understands his or her responsibilities and the appropriate IRM, LEM V, reasonable cause requirements.

Implementation Date: Proposed completion date: March 1, 1998.

Responsible Official: Chief, Collection Division

**Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District**

1C - Correction Action: Division and branch management will conduct quarterly post reviews of a sample of processed revenue officer abatements, using the same criteria as Corrective action 1A.

Implementation Date: Proposed completion dates: March 31, June 30, September 30, and December 31, beginning FY98.

Responsible Official: Chief, Collection Division

**Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District**

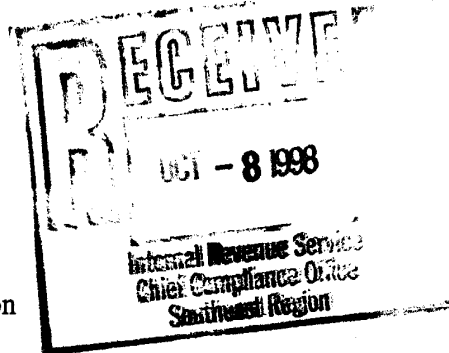
Appendix VI

**Internal Revenue Service
memorandum**

date: OCT 1 1998

to: Regional Inspector, Southeast Region
thru: Regional Commissioner, Southeast Region
Attn: Chief Compliance Officer, Southeast Region

from: District Director
Delaware-Maryland



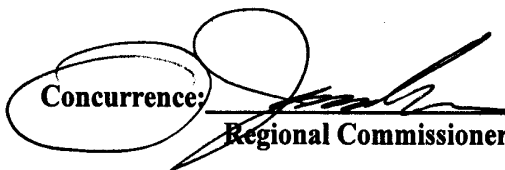
subject: Internal Audit Report - Review of Processing Controls over Taxpayer Account
Adjustments by Collection Personnel in the Delaware-Maryland District

Attached is our action plan and management response which appropriately addresses the area of concern in the above referenced Internal Audit Report.

Our previous responses to the IA report titled "Review of Abatements Associated with a Revenue Officer's Embezzlement" addressed the documentation and reasonable cause issues.

If you need additional information, please feel free to contact me or, if you prefer, a member of your staff may contact Mary Quiroz, Acting Chief, Collection Division at 410-962-3070.


Paul M. Harrington

Concurrence:  Regional Commissioner 10/15/98 Date

Weak Internal Controls Exposed Taxpayer Payments to Embezzlement in the Delaware-Maryland District

Identity of Finding

- I.** Forms 3870, Request for Adjustment, should not be returned to Revenue Officers after managerial approval.

Assessment of Cause

We agree with Internal Audit's assessment that our current procedure, which returns approved Forms 3870 to the Revenue Officer for processing to Special Procedures Branch or to the RTO's in outlying POD's, lacks the proper separation of duties and does not ensure that adjustment requests are forwarded directly from the approving authority to the staff members who input the adjustments to the taxpayers' accounts in the IRS' computer system.

Corrective Actions:

Attached is a copy of the new procedures for processing approved Forms 3870. These were distributed at an all manager's meeting for the Collection Division on September 30, 1998.

These new procedures require that after Forms 3870 are approved by the group manager, they will be forwarded directly to the group secretary for transmittal to Special Procedures or to the RTO's in outlying POD's for input using ENTITY transmittal forms. Part 3 of the Form 3870 will be returned to the revenue officer for inclusion in the case file. Special Procedures Branch and the RTO's will not accept any Forms 3870 for input that have not been forwarded on an ENTITY transmittal. These transmittals are only completed by group secretaries.

Implementation Date: September 30, 1998

Responsible Official: Acting Chief, Collection Division

Identity of Finding

- II.** Revenue Officers should not have the ability to submit adjustment documents directly to the Special Procedures Branch.

Weak Internal Controls Exposed Taxpayer Payments to Embezzlement in the Delaware-Maryland District

Assessment of Cause:

Management acknowledged that the subject revenue officer could have personally delivered forged adjustment documents to the Special Procedures Branch and placed them into the adjustment inventory awaiting computer terminal input. These forged documents would be undetected and input along with legitimate adjustments.

Corrective Action:

All Collection Forms 3870 are input by Special Procedures Branch or by RTO's in the outlying POD's. They are transmitted to Special Procedures or the RTO's via the Entity Group Daily document. In the memorandum delivered to all Collection Group Managers on September 30, 1998, we restated our current requirement that Forms 3870 requiring processing outside of the group daily be delivered to the Special Procedures Chief, Terminal Remittance Unit or the RTO's from the originating group manager. Only managers can request this expedited processing of Forms 3870.

Implementation Date: September 30, 1998

Responsible Official: Acting Chief, Collection Division

**Weak Internal Controls Exposed Taxpayer Payments
to Embezzlement in the Delaware-Maryland District**

**Internal Revenue Service
memorandum**

date: SEP 30 1998

to: All Managers and Revenue Officers
Collection Division

from: Acting Chief, Collection Division
Delaware-Maryland District

subject: Processing Controls for Form 3870

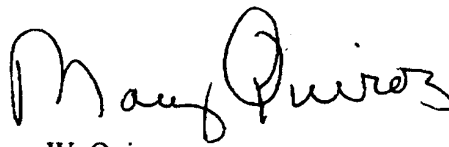
To improve controls over processing of adjustments by Collection employees, the following procedures will be implemented immediately.

After group manager approval of Form 3870, Part 3 will be returned to the revenue officer. The original and all attachments will be forwarded to the group secretary who will send them to the processing unit on an ENTITY transmittal.

The Terminal Remittance Unit and RTO's located in outlying POD's will only process Form 3870's with original signatures that are received on an ENTITY Transmittal. Face-To-Face employees will not process Form 3870's from field personnel. Expedited requests must be delivered to the processing unit personnel from the originating group manager. Only managers can request this expedited processing of Forms 3870.

Adjustments that do not require managerial approval should also be sent for processing on an ENTITY transmittal.

If you have any questions, please call Susanne Larson at (410) 962-9401.


Mary W. Quiroz